Value & Income Portfolio: Patience is a Virtue

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The older we get, the more "pattern recognition" we observe. By that, we refer to the Mark Twain quote that "history doesn't repeat itself, but it often rhymes."

Across the investment landscape, various asset classes wax and wane in terms of falling in and out of favor. While these may not be obvious in real time or on a day-to-day basis, they tend to be visible over intermediate to longer periods of time.

For example, smaller-cap stocks historically have outperformed their larger-cap counterparts – it should be easier for a $1 billion company to double in value than it is for a $1 trillion company to double. But that doesn't mean small-cap stocks ALWAYS outperform (indeed, much of their outperformance has occurred early in economic cycles). In fact, the chart below shows U.S. large-cap stocks (S&P 500® Index – shown in blue) have been toward the top of the leaderboard in nine of the last 11 years, paced by growth stocks. Over time, growth and value tend to take their turn in the sun. So, too, do individual sectors, as well as countries of domicile. What's in favor at a moment in time may very well be out of favor tomorrow, and vice-versa.

Annual Returns By Asset Class

Performance	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD 2024
Higher	Large Cap 13.69%	Large Cap 1.38%	Small Cap 21.31%	Emerg. Mkts 37.28%	Cash 1.86%	Large Cap 31.49%	Small Cap 19.96%	Large Cap 28.71%	Cash 1.50%	Large Cap 26.29%	Large Cap 10.56%
	Mid Cap 13.22%	Govt. Bonds 0.86%	Mid Cap 13.80%	International 25.03%	Govt. Bonds 0.88%	Mid Cap 30.54%	Large Cap 18.40%	Mid Cap 22.58%	Govt. Bonds -12.32%	International 18.24%	Mid Cap 8.60%
	Corp. Bonds 7.46%	Cash 0.03%	Large Cap 11.96%	Large Cap 21.83%	Corp Bonds -2.51%	Small Cap 25.52%	Emerg. Mkts 18.31%	Small Cap 14.82%	International -14.45%	Mid Cap 17.23%	International 5.78%
	Govt. Bonds 4.92%	Corp. Bonds -0.68%	Emerg. Mkts 11.19%	Mid Cap 18.52%	Large Cap -4.38%	International 22.01%	Mid Cap 17.10%	International 11.26%	Corp Bonds -15.76%	Small Cap 16.93%	Small Cap 5.18%
	Small Cap 4.89%	International -0.81%	Corp Bonds 6.11%	Small Cap 14.65%	Mid Cap -9.06%	Emerg. Mkts 18.42%	Corp Bonds 9.89%	Cash 0.05%	Mid Cap -17.32%	Emerg. Mkts 9.83%	Emerg. Mkts 2.37%
	Cash 0.03%	Mid Cap -2.44%	Govt. Bonds 1.05%	Corp Bonds 6.42%	Small Cap -11.01%	Corp Bonds 14.54%	Govt. Bonds 7.94%	Corp Bonds -1.04%	Large Cap -18.11%	Corp Bonds 8.52%	Cash 1.37%
	Emerg. Mkts -2.19%	Small Cap -4.41%	International 1.00%	Govt. Bonds 2.30%	International -13.79%	Govt. Bonds 6.83%	International 7.82%	Govt. Bonds -2.28%	Emerg. Mkts -20.09%	Cash 5.26%	Corp Bonds -0.40%
Lower	International -4.90%	Emerg. Mkts -14.92%	Cash 0.27%	Cash 0.84%	Emerg. Mkts -14.58%	Cash 2.25%	Cash 0.58%	Emerg. Mkts -2.54%	Small Cap -20.44%	Govt. Bonds 4.09%	Govt. Bonds -0.93%

Source: Morningstar Direct

In a similar vein, dividend-paying stocks historically have outperformed their non-dividend-paying counterparts. In fact, dividends historically have comprised about 30-40% of the stock market's total return (30% since 2002, 40% since 1930). But that is not ALWAYS the case – there are plenty of periods when high-flying concept stocks with no dividend history at all soar to the stratosphere.

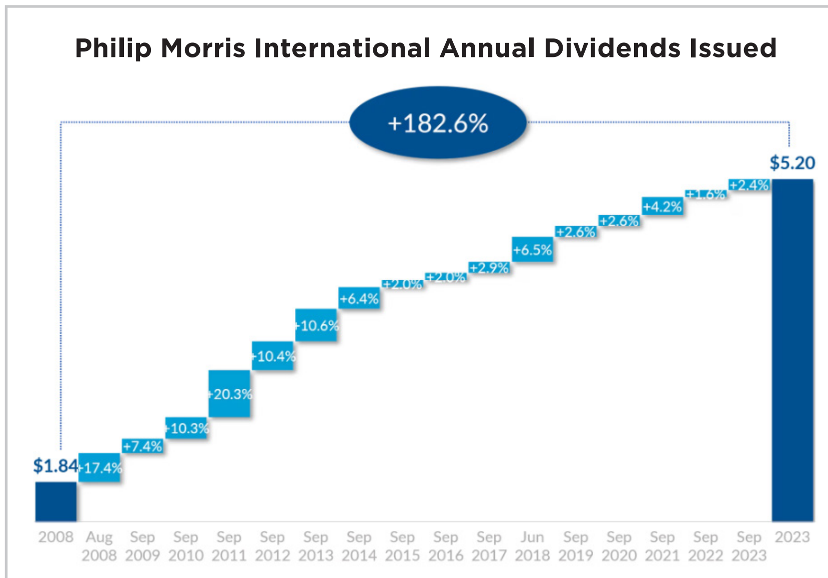
Our preference for companies arises more from their financial characteristics (valuation, balance sheet strength, growth opportunities) and less from their size, country of domicile, or which sector S&P arbitrarily places them. Within the Davenport Value & Income Portfolio, we seek companies with reasonable valuations (who wants to intentionally pay too much for any asset?), solid finances (who doesn't prefer financial flexibility?), and reasonable growth potential that translates into a cash flow stream enabling good dividend track records (who doesn't like a pay raise each and every year?).

Most companies with such characteristics face a very high-quality problem: they generate more cash flow than they can possibly use to grow their businesses. After fully funding all of their capital needs (manufacturing facilities, warehouses), all their human needs (staff, sales people), and all their new-product innovation (R&D), these companies still have discretionary cash flow with which to pay dividends and/or buy back their shares (making each shareholder's ownership slice a bit larger as a percent of the total pie).

With many of these stocks, patience is a virtue. While the growth rate of dividend stalwarts typically isn't as eye-popping as the newest initial public offering (IPO), their ability to churn out consistent results over the long arc of time differentiates them. These stocks may not be standout performers in any given year (they're not swing-for-the-fences type investments), as they tend to deliver relatively steady performance most years (they're more like a contact hitter that reaches base a high percentage of the time). Patiently sticking with these stocks over time tends to be rewarded.

To that point, Davenport's Value & Income Portfolio (VIP) has owned seven stocks for more than a decade, those being Philip Morris International Inc. (PM), Chevron Corp (CVX), Fidelity National Financial Inc. (FNF), JPMorgan Chase & Co (JPM), Markel Group Inc. (MKL), Johnson & Johnson (JNJ), and Watsco Inc. (WSO). Three of those stocks (FNF, JPM and WSO) have outperformed the S&P 500 significantly over the past decade, and an equally weighted portfolio of all seven slightly outperformed the S&P 500, despite that cohort not containing a single hyper-growth company. That's a reminder that good investments can come from any sector, any size company, and any country of domicile.

Incidentally, that cohort of seven includes several dividend stalwarts: Johnson & Johnson has raised its dividend 62 consecutive years, while Chevron has increased its 37 years in a row. Watsco and Philip Morris have done their part, having grown their dividend each year that we've owned them in VIP.



Source: Philip Morris International

Those who churn or trade their positions don't benefit from all those dividends, while investors who sit back and allow good managements to run their companies tend to be rewarded. VIP is a relatively low-turnover portfolio, where we seek to demonstrate a healthy degree of patience in allowing our investments to work hard on our behalf. As Berkshire Hathaway's Charlie Munger said: "The big money is not in the buying and selling, but in the waiting."

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